INDEX

	Page
Opinions below	1
Jurisdiction	2
Questions presented	2
Statutes involved	3
Statement	3
Summary of Argument	9
Argument:	
I. If the amounts received by the beneficiary were properly distributable to her, she was not entitled to deduct anything on account of depreciation	13
II. Apart from the effect of the decree of the California court, the petitioner has not shown that all of the income paid to the beneficiary was not properly distributable to her	16
III. The order of the California court is not conclusive in this proceeding	27
IV. The effect of the California court decree is at most to entitle the beneficiaries to a deduction from their income in the year in which they make payment pursuant to the decree	40
Conclusion	43
Appendix A (Statutes involved)	44
Appendix B (Family tree)	51

CITATIONS

Cases:	
Abell v. *Brady*, 79 Md. 94	22
Abell v. *Tait*, 30 F. (2d) 54, certiorari denied, 279 U.S. 849	14
Anderson v. *Wilson*, 289 U.S. 20	9, 15
Atwood v. *Rhode Island Hospital Trust Co.*, 34 F. (2d) 18	32
Baltzell v. *Mitchell*, 3 F. (2d) 428, certiorari denied, 268 U.S. 690	14
B. & W. Taxi Co. v. *B. & Y. Taxi Co.*, 276 U.S. 518	11, 30
Barber v. *Pittsburgh, Ft. Wayne & Chicago Ry. Co.*, 166 U.S. 83	29
Bate v. *Hooper*, 5 DeG. M. & G. 338	35
Bigelow v. *Old Dominion Copper Co.*, 225 U.S. 111	28
Boal v. *Metropolitan Museum of Art*, 19 F. (2d) 454	32
Board v. *Commissioner*, 51 F. (2d) 73, certiorari denied, 284 U.S. 658	27
Bucher v. *Cheshire Railroad Co.*, 125 U.S. 555	29

Cases—Continued.

	Page
Burgess v. *Seligman*, 107 U.S. 20	29
Burnet v. *Sanford & Brooks Co.*, 282 U.S. 359	42
Burnet v. *Whitcomb*, 65 F. (2d) 803	14
Chapman, Matter of, 32 Misc. 187, affirmed, 59 App. Div. 624, affirmed, 167 N.Y. 619	21
Charleston & W. C. Ry. Co. v. *Burnet*, 50 F. (2d) 342	42
Chicago, R. I. & P. Ry. Co. v. *Commissioner*, 47 F. (2d) 990, certiorari denied, 284 U.S. 618	42
Cleveland Ry. Co. v. *Commissioner*, 36 F. (2d) 347, certiorari denied, 281 U.S. 743	27
Codman v. *Commissioner*, 50 F. (2d) 763	14
Codman v. *Miles*, 28 F. (2d) 823, certiorari denied, 278 U.S. 654	14
Commissioner v. *Brooklyn Union Gas Co.*, 62 F. (2d) 505	27
Commissioner v. *Field*, 42 F. (2d) 820	32
Commissioner v. *Freuler*, 62 F. (2d) 733	14
Crabtree, In re, 106 Law Times Rep. (N.S.) 49	21
Farwell v. *Commissioner*, 38 F. (2d) 791	33
Fidelity & Columbia Trust Co. v. *Lucas*, 52 F. (2d) 298, 56 F. (2d) 116	37, 38
Ford v. *Commissioner*, 51 F. (2d) 206, certiorari denied, 284 U.S. 666	25, 42
Gartenlaub, In re, 185 Cal. 618	31
Gordon v. *Wansey*, 21 Cal. 77	37
Greene v. *Greene*, 19 R.I. 619	22
Helvering v. *Falk*, No. 225, October Term, 1933	13, 15
Housman, Matter of, 4 Dem. (N.Y.) 404	21
Hubbell v. *Burnet*, 46 F. (2d) 446, certiorari denied, 283 U.S. 840	14, 20
Jackson v. *Smietanka*, 272 Fed. 970	26
Jones, Matter of, 103 N.Y. 621	19
Kaufmann v. *Commissioner*, 44 F. (2d) 144	14
Keith v. *Johnson*, 271 U.S. 1	31
Knights of Pythias v. *Meyer*, 265 U.S. 30	28
Kuhn v. *Fairmont Coal Co.*, 215 U.S. 349	30
Lane v. *Vick*, 3 How. 463	29
McCaughn v. *Girard Trust Co.*, 19 F. (2d) 218	33
Michigan v. *Michigan Trust Co.*, 286 U.S. 334	31
Newman v. *Commissioner*, 40 F. (2d) 225, certiorari denied, 282 U.S. 858	27
North American Oil Consolidated v. *Burnet*, 286 U.S. 417	11, 25, 42
Oates v. *National Bank*, 100 U.S. 239	29
Old Colony Trust Co. v. *Omaha*, 230 U.S. 100	23
Pitman v. *Commissioner*, 64 F. (2d) 740	31
Pyle v. *Commissioner*, 16 B.T.A. 218	41
Railroad Co. v. *National Bank*, 102 U.S. 14	29
Reinecke v. *Spaulding*, 280 U.S. 227	19
Reynolds v. *Cooper*, Nos. 227–229, October Term, 1933	13
Rodrigues v. *Edwards*, 40 F. (2d) 408	27

	Page
Cases—Continued.	
Roxburghe v. *Burnet*, 58 F. (2d) 693, certiorari denied, 278 U.S. 598	14
Roxburghe v. *United States*, 64 C.Cls. 223, certiorari denied, 278 U.S. 598	14, 21
Smith v. *Ketellas*, 62 App. Div. 174	21
Snell v. *Davis*, 149 Ill. App. 391	37
Southern Pacific Railroad v. *United States*, 168 U.S. 1	21
Swift v. *Tyson*, 16 Pet. 1	11, 28
United States v. *Kombst*, 286 U.S. 424	31
United States v. *Mahoning Coal R.R. Co.*, 51 F. (2d) 208, certiorari denied, 285 U.S. 559	26
Uterhart v. *United States*, 240 U.S. 598	32
Vang v. *Lewellyn*, 35 F. (2d) 283	27
Wear v. *Commissioner*, 65 F. (2d) 665	26
Weiss v. *Wiener*, 279 U.S. 333	9, 15
Whitcomb, Appeal of Louise P. V., 4 B.T.A. 80	6, 9, 14
Whitcomb, Marguerite T., v. *Commissioner*, 5 B.T.A. 191	6
Whitcomb v. *Blair*, 25 F. (2d) 528	6, 9, 14, 24, 33
Williams, Appeal of, 1 B.T.A. 1101	24, 42
Statutes:	
Revenue Act of 1921, c. 136, 42 Stat. 227, 239, 246:	
Sec. 214 (a) (5)	44
Sec. 214 (a) (8)	44
Sec. 219	44
Revenue Act of 1924, c. 234, 43 Stat. 253, 269, 275:	
Sec. 214 (U.S.C., Title 26, Sec. 955)	47
Sec. 219 (U.S.C., Title 26, Sec. 960)	47
Revenue Act of 1926, c. 27, 44 Stat. 9, 26, 32:	
Sec. 214 (U.S.C. App., Title 26, Sec. 955)	50
Sec. 219 (U.S.C. App., Title 26, Sec. 960)	50
Revised Statutes, Sec. 905 (U.S.C., Title 28, Sec. 687)	28
Miscellaneous:	
2 Freeman, *Judgments* (5th ed.) Sec. 811	32
House Report No. 179, 68th Cong., 1st Sess., p. 21	40
2 Perry, *Trusts* (7th ed.) Sec. 855	36
Restatement of Trusts:	
Sec. 218	35
Sec. 225, Comment *i*	22
Senate Report No. 398, 68th Cong., 1st Sess., p. 25	40
1 Williston, *Contracts*, p. 630	37

In the Supreme Court of the United States

OCTOBER TERM, 1933

No. 129

JOHN FREULER, ADMINISTRATOR OF THE ESTATE OF Louise P. V. Whitcomb, petitioner

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINION BELOW

The opinion of the Board of Tax Appeals (R. 32–53) is reported in 22 B.T.A. 118. The opinion of the Circuit Court of Appeals for the Ninth Circuit (R. 154–160) is reported in 62 F. (2d) 733. The opinion of the Court of Appeals of the District of Columbia in other cases involving the same question (R. 163–174) is reported in 65 F. (2d) 803.[1]

[1] By stipulation between the parties (R. 177–178), the decision in this case is to control the decision in eight other cases involving different tax years and other life beneficiaries of the same trust. These cases are Nos. 130 and 131 on writs of certiorari to the Circuit Court of Appeals for the Ninth Circuit and Nos. 139–144, on writs of certiorari to the Court of Appeals of the District of Columbia.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered January 9, 1933. (R. 161.) On March 16, 1933, the period for filing a petition for certiorari, was extended for sixty days by order of a Justice of this Court. (R. 175.) The petition for writs of certiorari was filed June 6, 1933. The petition was granted October 9, 1933. (R. 176.) The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether the life beneficiaries of a testamentary trust may deduct from the amounts actually distributed to them any amount for depreciation of the trust property on the ground that the amounts actually distributed were in excess of the sums properly distributable because the trustee had not reserved any amount on account of depreciation of the trust property.

2. Where the income of a testamentary trust, without deduction for depreciation of the trust property, has been distributed to the beneficiaries, whether an order of the State superior court, entered years later, directing the beneficiaries to refund a portion of the distributed income as depreciation which should have been retained by the trustee, is conclusive in determining the amount of the trust income distributable and taxable to the beneficiaries during the years when the payments were received.

STATUTES INVOLVED

The statutes involved are set forth in Appendix A, *infra*, pp. 44–50.

STATEMENT

The findings of fact of the Board of Tax Appeals (R. 34–42) may be summarized as follows:

Louise P. V. Whitcomb was from sometime in 1889 until her death on June 14, 1921, the widow of A. C. Whitcomb, deceased. (R. 34.) The administrator of her estate is the petitioner here. The present case involves the taxes due on income received by her during 1921, until June 14, 1921, the date of her death.[2]

A. C. Whitcomb died in 1889, a resident of California, leaving a will which was duly admitted to probate by the Superior Court of California in and for the City and County of San Francisco. (R. 34.) The will provided, among other things, as follows (R. 34–35):

> 7th. I give to my hereinafter named Executor, Jerome Lincoln, of San Francisco, all the rest of my property, real, personal or mixed, except what I may have in France, of every kind and nature and not hereinbefore disposed of, after the payment of my debts, in *Trust*, nevertheless, to pay over to my said wife, Louise Palmyre Vion Whitcomb,

[2] Of the other cases dependent on the decision in this case, Nos. 130 and 131 involve taxes of the same beneficiary for other periods, and Nos. 139–144 involve taxes of other beneficiaries of the trust created by A. C. Whitcomb's will. See Appendix B, *infra*, p. 51.

> one-third part of the interest thereon or income therefrom, for and during her natural life, and the other two-thirds parts to my two children, born of her; one, Adolph, born on or about the 23rd day of February, 1880, and the other, Charlotte Andree, born on or about the 4th day of December, 1882, with the reversion or remainder of the whole three-thirds parts to the descendants "per stirpes" of the said two children, if any be alive at the time of the death of the said two children; and if none be alive at that time, to Harvard College, in conformity with the provisions named or indicated in Section Six (6) of this Will, having reference to said Harvard College.

The will contained no directions in regard to the manner in which the income from the trust should be computed, accounts kept, or depreciation provided for. (R. 35.)

James Otis was appointed a trustee of this testamentary trust on February 23, 1896. He has acted as such trustee continuously since that date, and since the year 1905 he has been the sole trustee of the trust. (R. 35.)

The original trust estate consisted largely of cash, bonds, stocks, and notes. On February 23, 1906, the trust estate consisted of bonds, corporate stocks, cash, and promissory notes secured by mortgages, of a total value of more than $3,000,000, and certain parcels of real estate, most of which were in San Francisco. On April 18, 1906, the San Francisco earthquake and fire occurred. All of the improve-

ments on the San Francisco real estate owned by the trust were destroyed by the fire, including those on the large parcel at Eighth and Market Streets, which the trust still owns and on which the Hotel Whitcomb now stands. Some time after the San Francisco fire the trustee adopted the policy of improving the real estate owned by the trust and of converting the other assets of the estate to accomplish that purpose. As a result of that policy and of the acquisition of additional parcels of real estate, the assets of the trust for several years prior to 1921, and during the years 1921 to 1926, inclusive, consisted almost entirely of improved real estate, including the Whitcomb Hotel and its furniture and equipment. The last item represented an investment of more than $2,000,000. (R. 35–36.)

During the years 1921 to 1926, inclusive, the trust estate suffered exhaustion, wear and tear, as follows (R. 36):

1921	$43,003.16	1924	$39,258.00
1922	39,408.00	1925	39,108.00
1923	39,408.00	1926	55,833.00

The trustee filed fiduciary returns for the years 1921 to 1926, inclusive, and deducted in computing the net income of the trust for each year the respective amounts above set forth, representing exhaustion, wear and tear sustained by the trust. The trustee, however, did not withhold from the beneficiaries to whom income payments were being made the amounts represented in the depreciation deduction, and each of these beneficiaries received her ratable share of trust income, undiminished by depreciation, during

the years involved, as well as in preceding years. (R. 37–38.)

From 1903 to 1928, inclusive, the trustee or trustees of the trust presented an annual account to the beneficiaries entitled to income payments, but did not file any account in the Superior Court of California, which has jurisdiction over the trust until its termination, for the settlement of accounts and for other purposes. (R. 38.)

On September 5, 1928, James Otis, as trustee, filed with the Superior Court in San Francisco his account accompanied by a petition for its allowance.[3] The account covered the period from February 23, 1903, to February 23, 1928. (R. 38.) The allowance and approval of the account was opposed by Napoleon Charles Louis Lepic and Charlotte de Rochechouart, nonresident children of Charlotte A. W. Lepic, one of the life beneficiaries of the trust, who are two of the remaindermen entitled to a part of the corpus of the trust upon its termination, if they be then living. In their objections, which were filed on September 7, 1928, they alleged that the trust property had sus-

[3] This account was filed after the Court of Appeals of the District of Columbia in *Whitcomb* v. *Blair*, 25 F. (2d) 528, decided April 2, 1928, had held that one of the beneficiaries of the trust (and the petitioner here in Nos. 139, 141 and 144) was not entitled in the computation of her tax for the year 1918 to a deduction on account of the depreciation of the trust property. This decision affirmed the decision of the Board of Tax Appeals in *Marguerite T. Whitcomb* v. *Commissioner*, 5 B.T.A. 191. A similar result had previously been reached by the Board in *Appeal of Louise P. V. Whitcomb*, 4 B.T.A. 80, involving the taxes of three of the present petitioners for the years from 1917 through 1920.

tained depreciation during the years 1913 to 1927, inclusive, in the amount of $622,434.11; that no reserve or other provision for such depreciation had been made from the gross income of the trust estate; that this amount of $622,434.11 had been paid by the trustee to the beneficiaries of the trust entitled to the income therefrom, as income, thus impairing the trust property by that amount, and they prayed that the trustee be charged with that amount. All of the parties interested in the trust estate were notified of the filing of the account of the trustee, and of the objections, and were represented by counsel at the hearing. (R. 38–39.)

On September 19, 1928, the Superior Court of California, at San Francisco, entered two orders, one original and the other an amending order, settling the trustee's account. (R. 39–41, 136–139, 140–144.) In substance they sustain the objections of the two remaindermen and decree the repayment of the amounts claimed to have been erroneously distributed as income in the several years from 1913 to 1927. The first order directs the payment by delivery of promissory notes, payable without interest at the termination of the trust to the remaindermen as then determined. The amended order omits reference to the manner in which the several sums are to be repaid. The orders also direct the trustee to withhold annually from and after February 23, 1927, a proper amount from income as a depreciation reserve.

On January 17, 1929, Louise A. Whitcomb, Marguerite T. Whitcomb, Lydia L. Whitcomb,

Charlotte A. W. Lepic, Napoleon Charles Louis Lepic, and Charlotte de Rochechouart, all acting through John Freuler, as attorney in fact, executed and delivered to James Otis as trustee their promissory notes in the aggregate amount of $611,734.11. (R. 42.) Charlotte A. W. Lepic, Napoleon Charles Louis Lepic, and Charlotte de Rochechouart were makers of a joint note. (R. 145.) The other notes were separate notes of the individuals concerned. (R. 146, 147, 148.) These notes bear no interest and by their terms are payable at the termination of the trust, which will be upon the death of Charlotte A. W. Lepic. A payment of $10,700 has been made to the trust by the administrator of the estate of Louise P. V. Whitcomb, the present petitioner. (R. 42.)

The life beneficiaries, in their returns of income for the years mentioned, did not include the amounts paid to them in those years by the trustee representing their proportionate share of the depreciation sustained and deducted on the fiduciary return of the estate. The respondent increased the income shown on the several returns by the proportionate share of depreciation, thus including in taxable income the full amount of the payments received by each beneficiary, and determined deficiencies in tax accordingly. (R. 42.) The Board of Tax Appeals, with six members dissenting, reversed the determination of the Commissioner. (R. 42–53, 54.) The Circuit Court

of Appeals reversed the decision of the Board and sustained the action of the Commissioner. (R. 154–160, 161.)

SUMMARY OF ARGUMENT

I

If the amounts received by the beneficiary were properly distributable to her, she was not entitled to deduct anything on account of depreciation. The petitioner concedes that the beneficiary is taxable on the full amount of the payments which were distributable to her, but contends that the amounts representing depreciation should not have been distributed, and are for that reason alone not taxable.

The petitioner's concession that the beneficiary of a trust is not entitled to a deduction from payments properly received on account of depreciation which the trust property may have sustained is required by all of the authorities which have considered the question. The concession is the more apt in the present case because the decisions in *Appeal of Louise P. V. Whitcomb*, 4 B.T.A. 80, and in *Whitcomb* v. *Blair*, 25 F. (2d) 528 (App.D.C.), were made in cases arising out of the very trust now before the Court and involved some of the beneficiaries who are now petitioners here.

The conclusion that the beneficiary of a trust is not entitled to a deduction on account of depreciation sustained by the trust property seems to be required by the decisions in *Anderson* v. *Wilson*, 289 U.S. 20, and in *Weiss* v. *Wiener*, 279 U.S. 333.

II

The entire amount of the payments made to the beneficiary in this case were distributable to her, so that even under the petitioner's construction of Section 219 (d) of the Revenue Act of 1921 (*infra*, p. 46) the deficiencies asserted in this case should be sustained. The question of the distributability of the payments in dispute is one of the proper method of allocating trust receipts between life tenants and remaindermen. It is a question of general trust law quite independent of the income tax statutes.

The correct rule, we submit, is that the trustee may deduct from income payable to life beneficiaries the entire amount of current expenses, including the cost of repairs and including, as well, the cost of renewals of personal property worn out or consumed in the administration of the trust. If the trustee deducts the cost of repairs and renewals in computing the net income payable to life beneficiaries he may not also take a deduction for depreciation. There is nothing in this record to show that the trustee has not deducted in full the cost not only of repairs but also of renewals as they were made. In fact, the inference is to the contrary.

That this is the rule properly applicable to the will here in question is evidenced by the long continued practical construction of the instrument.

Moreover we submit that income *distributable* within the meaning of Section 219 is income which was reasonably regarded by the parties as distributable at the time it was distributed. As this Court

held in *North American Oil Consolidated* v. *Burnet*, 286 U.S. 417, 424, if a taxpayer receives money "under a claim of right and without restriction as to its disposition, he has received income which he is required to return."

III

The order of the California court is not conclusive in this proceeding. The petitioner concedes that the judgment is not binding here on the basis of *res judicata*, and it is equally obvious that the decision is not binding as an *in rem* decree. It has long been settled that under these circumstances the only decisions of State courts which are conclusive upon the Federal courts are those of the highest court of the State interpreting State statutes or applying a settled rule of property. The decisions to this effect have been unbroken from *Swift* v. *Tyson*, 16 Pet. 1, to *B. & W. Taxi Co.* v. *B. & Y. Taxi Co.*, 276 U.S. 518.

The true rule to be deduced from all the cases is, we submit, that when a State court of appropriate jurisdiction has determined the extent of the rights of the parties under a will or trust, and payments are thereafter actually made to the parties in accordance with that decision, then the State decision is conclusive in determining their Federal tax liability because it has as a matter of fact determined the payments which the parties have received. Where, however, as here, the State court decision did not, in fact, control the amount of the payments, it is without effect in determining Federal tax liability.

In the present case, the fact remains that in spite of the State decision the beneficiaries have received the money, and (except for one unidentified payment of $10,700) still have it.

Moreover, a consideration of the facts shown by this record makes it plain, we contend, that the order of the State court was nothing more than a friendly settlement without any real contest, and did not represent a considered adjudication of the questions involved. The judgment of the State court entered in such a proceeding is only a *pro forma* determination and certainly should not be accepted as binding upon the Federal courts with respect to past rights, if it is entitled even to that respectful consideration accorded to the decisions of State courts.

IV

The effect of the California court decree is at most to entitle the beneficiaries to a deduction from their income in the year in which they make payment pursuant to the decree. No part of the income received by the beneficiaries has been repaid to the trustee, except the sum of $10,700 repaid by the petitioner, and there is nothing to indicate for what year this repayment was made nor when it was made.

When repayments to the trustee are, in fact, made they may form a basis for a deduction in the year of repayment, but they cannot operate retroactively to render the amounts actually received any less income taxable to the beneficiaries in the year such income was received.

ARGUMENT

I

IF THE AMOUNTS RECEIVED BY THE BENEFICIARY WERE PROPERLY DISTRIBUTABLE TO HER, SHE WAS NOT ENTITLED TO DEDUCT ANYTHING ON ACCOUNT OF DEPRECIATION

The sole contention of the petitioner is that part of the sum which the beneficiary actually received from the trustee should not have been paid to her, and that under Section 219 of the Revenue Act of 1921 (*infra*, p. 44) the beneficiary is taxable only on sums which were properly *distributable* to her.

If the sums received by the beneficiary were properly distributable to her, the petitioner makes no contention that they were not taxable to her in full. The question presented is, therefore, not the same as that involved in the cases of *Helvering* v. *Falk*, No. 225, and *Reynolds* v. *Cooper*, Nos. 227-229, October Term, 1933, which are to be argued immediately following this case. In those cases it is plain that the amounts received by the beneficiaries were distributable to them in full, and the contention is that nevertheless the beneficiaries may deduct from their income amounts on account of the depletion of part of the property owned by the trust. The present petitioner concedes that the beneficiary is taxable on the full amount of the payments which were properly distributable to her, but contends that the amounts representing depreciation should not have been distributed, and are for that reason alone not taxable.

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The petitioner's concession that the beneficiary of a trust is not entitled to a deduction from payments properly received on account of depreciation which the trust property may have sustained is required by all of the authorities which have considered the question. *Roxburghe* v. *Burnet*, 58 F. (2d) 693 (App. D.C.), certiorari denied, 278 U.S. 598; *Codman* v. *Commissioner*, 50 F. (2d) 763 (C.C.A. 1st); *Hubbell* v. *Burnet*, 46 F. (2d) 446 (C.C.A. 8th), certiorari denied, 283 U.S. 840; *Kaufmann* v. *Commissioner*, 44 F. (2d) 144 (C.C.A. 3d); *Abell* v. *Tait*, 30 F. (2d) 54 (C.C.A. 4th), certiorari denied, 279 U.S. 849; *Codman* v. *Miles*, 28 F. (2d) 823 (C.C.A. 4th), certiorari denied, 278 U.S. 654; *Whitcomb* v. *Blair*, 25 F. (2d) 528 (App. D.C.); *Appeal of Louise P. V. Whitcomb*, 4 B.T.A. 80; *Roxburghe* v. *United States*, 64 C. Cls. 223, certiorari denied, 278 U.S. 598. Cf. *Baltzell* v. *Mitchell*, 3 F. (2d) 428 (C.C.A. 1st), certiorari denied, 268 U.S. 690, involving a capital loss. This conclusion was also reached in the decisions of the two courts below in the present case. *Commissioner* v. *Freuler*, 62 F. (2d) 733 (R. 154, 159); *Burnet* v. *Whitcomb*, 65 F. (2d) 803 (R. 163, 168–170).

The concession is the more apt in the present case because the decisions in *Appeal of Louise P. V. Whitcomb*, 4 B.T.A. 80, *supra*, and in *Whitcomb* v. *Blair*, 25 F. (2d) 528, *supra*, were made in cases arising out of the very trust now before the Court; the former case involved the very beneficiary whose administrator is now petitioner in this Court, to-

gether with two of the other beneficiaries, while the latter case involved the taxpayer who is petitioner in Nos. 139, 141, and 144 (three of the cases controlled by the present decision), with respect to taxes for an earlier year.

As is pointed out in the Government's brief in *Helvering* v. *Falk*, No. 225, the conclusion that the beneficiary of a trust is not entitled to a deduction on account of depreciation sustained by the trust property seems to be required by the decisions of this Court in *Anderson* v. *Wilson*, 289 U.S. 20, and in *Weiss* v. *Wiener*, 279 U.S. 333. In the *Wilson* case, this Court, citing several of the above cases with approval (p. 27), held that the beneficiary of a trust was not entitled to a deduction on account of capital losses sustained on the sale of part of the trust property, even though the beneficiary was ultimately entitled to receive the proceeds of the sale. There seems to be no basis for a distinction in this respect between losses resulting from sales and losses resulting from depreciation. In *Weiss* v. *Wiener*, it was held that a lessee was not entitled to a deduction for depreciation of buildings on the leased property because the depreciation did not represent a loss of the lessee's capital. If a lessee is not entitled to a deduction on account of the depreciation of leased property it would seem to follow necessarily that the life beneficiary of a trust is not entitled to such a deduction.

II

APART FROM THE EFFECT OF THE DECREE OF THE CALIFORNIA COURT, THE PETITIONER HAS NOT SHOWN THAT ALL OF THE INCOME PAID TO THE BENEFICIARY WAS NOT PROPERLY DISTRIBUTABLE TO HER

Section 219 (d) of the Revenue Act of 1921 (*infra*, p. 46) provides that where income of a trust is to be distributed to the beneficiaries periodically,

> the tax shall not be paid by the fiduciary, but there shall be included in computing the net income of each beneficiary that part of the income of the estate or trust for its taxable year which, pursuant to the instrument or order governing the distribution, is distributable to such beneficiary, whether distributed or not, * * *.

The petitioner's position is that under a literal reading of this statute the beneficiary was taxable only on so much of the income of the trust as was *distributable* to her. We contend that the entire amount of the payments made to the beneficiary in this case were distributable to her, so that even if the petitioner's construction of the statute be correct, the deficiencies asserted in this case should be sustained.

In contending that the amount in question here was not distributable to the beneficiary, the petitioner relies both on the order of the California superior court and on the ground that as a matter of general law, the trustee should have withheld a reserve for depreciation. The question of the effect of the California court order is discussed in Point III (*infra*, pp. 27–40). Apart from the effect of that order,

we contend here that the petitioner has not shown that all of the income paid to the beneficiary was not properly distributable to her.

It is to be noted that the question thus presented is not how the trustees should have made out their income tax returns, nor whether they or anybody else was entitled to a deduction for depreciation in computing income taxes. The question is one of the proper method of allocating trust receipts between life tenants and remaindermen. It is a question of general trusts law quite independent of the income tax statutes.

The correct rule, we submit, is that a trustee conducting a business may deduct from income payable to life beneficiaries the entire amount of current expenses, including the cost of repairs and including as well the cost of renewals of personal property worn out or consumed in the administration of the trust. Of course, if he deducts the cost of repairs and renewals in computing the net income payable to life beneficiaries, he may not also take a deduction for depreciation. *There is nothing in this record to show that the trustee has not deducted in full the cost not only of repairs but also of renewals as they were made.* In fact, the inference is to the contrary.

The only information in the record as to how the amounts payable to the beneficiaries were calculated is that contained in the account filed by the trustee with the Superior Court on September 5, 1928 (R. 110–125), together with the statement in the findings (R. 38) that the trustee did not withhold from the beneficiaries any amounts for depreciation.

The account of the trustee, however, contains for each year only two items, one for "Income received" and another for "Expenses paid." There is nowhere any indication of the individual items going to make up the "Expenses paid." Since the trustee was continuously and successfully operating the trust property, including a hotel which, with its furniture and equipment, represented an investment of more than $2,000,000 (R. 36), it would seem to follow as a necessary conclusion that the trustee must have paid out each year large sums not only for repairs of the trust property but also for renewals. As the sheets and pillows and rugs and furniture and glassware and kitchen utensils used in the operation of the hotel were worn out or broken or became unserviceable, they must have been replaced, and it seems a fair inference that the cost of these replacements must have been included each year in the item of "Expenses paid," and the life beneficiaries' income reduced accordingly. In any event, there is nothing whatever in the record to show that payments on this account were not deducted in computing the sum payable to the beneficiary in this case.[4]

The distinction for which we contend between the allowance of a gross sum for depreciation on the one

[4] It might be contended that this argument is applicable only to the personal property used by the trustee in the operation of the hotel, and that it does not apply to the hotel building itself. But the depreciation which the petitioner claims should have been deducted from the beneficiary's interest covers furniture and equipment as well as the building, and the record furnishes no basis for allocating it in part to personal property and in part to the building. The

hand, and current payments by the trustee for repairs and renewals on the other hand, is plainly illustrated by *Matter of Jones*, 103 N.Y. 621, one of the cases cited by the petitioner himself (Br. 36) in support of his position that the trustee should withhold from income payable to life beneficiaries a sum equivalent to the depreciation of the trust property. Despite the petitioner's statement to the contrary (Br. 36) that case did not involve depreciation of real estate. No one there contended that the trustee should withhold from the income payable to the life tenants a gross sum for depreciation. Instead, it appeared (pp. 623–624) that "Various appliances and articles which had been worn out in the conduct of the business, as well as horses which had died, were replaced by the executors, and the amount paid therefor charged against the life tenants. Certain items for repairs were also charged against the life tenants." The question presented, as stated by the court (p. 624) was whether these items "were proper charges against the income." The court held that they were. It said (p. 624):

> While a case might arise where a large expenditure, as, for instance, the erection of additional buildings, might be such an improvement of the real estate as to become an addition

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burden of proof is on the petitioner (*Reinecke* v. *Spaulding*, 280 U.S. 227), and even if it should be concluded that the trustee should have deducted something on account of the depreciation of the building in addition to the expenses which he may have incurred for its repair, the record does not show the amount of depreciation sustained by the building alone.

> to the capital employed, yet ordinary expenditures for repairs or improvement would not be embraced within any such rule. So, also, in reference to the wearing out, loss of or depreciation of personal property, it cannot well be claimed that moneys expended to replace the same should not be deducted from the income received or profits realized.

This decision, we contend, represents the correct view. The trustee may deduct from the income payable to life beneficiaries sums actually expended for repairs and for replacements. As has been pointed out, it does not appear that the trustee has not made such deductions here. If he has made deductions of expenses actually incurred for such items, it must follow necessarily that he may not deduct an additional sum in gross on account of depreciation.

The general rule of trust law, that a trustee may not withhold from income payable to a life beneficiary a sum in gross on account of the depreciation of the trust property, is supported by the decisions which have held that the life beneficiary of a trust may not take a deduction on account of the depreciation of the trust property. Several of these cases were based on the ground that as a matter of the law of trusts the net income of the trust was distributable by the trustee to the beneficiary without any deduction on account of depreciation. *Hubbell* v. *Burnet*, 46 F. (2d) 446, 450 (C.C.A. 8th), certiorari denied, 283 U.S. 840; *Whitcomb* v. *Blair*, 25 F. (2d) 528, 529 (App.D.C.).[5] Cf. *Roxburghe* v. *United States*, 64 C.Cls.

[5] In fact, the petitioner himself contends (Br. 20–21) that the court in *Whitcomb* v. *Blair* based its determination that

223, certiorari denied, 278 U.S. 598. The same result is also supported by other decisions not involving taxes. In *Smith* v. *Keteltas*, 62 App. Div. 174, it was held (p. 181) that it was not the trustee's duty to "withhold from the life tenant moneys out of the income for the purpose, not of repair, but of erecting whole new buildings when those already upon the premises, should be reason of lapse of time, become incapable of further repair." See also *Matter of Chapman*, 32 Misc. 187, affirmed, 59 App. Div. 624, affirmed, 167 N.Y. 619.

The decision in *In re Crabtree*, 106 Law Times Rep. (N.S.) 49, upon which the petitioner relies (Br. 36), is plainly distinguishable. It did not involve real property, and accordingly it does not hold that a trustee should deduct from the income payable to a life beneficiary any sum on account of the depreciation of a building.[6] The question there

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the payments reserved by the taxpayer were taxable in full on the ground that these amounts were properly *distributable*. See also the similar argument at p. 23 of the petitioner's brief.

This question was decided in *Whitcomb* v. *Blair*, not assumed. So far as the appellant in that case (the petitioner here in Nos. 139, 141, and 144) is concerned, that decision would seem to be *res judicata* of this issue, even though not pleaded. *Southern Pacific Railroad* v. *United States*, 168 U.S. 1.

[6] Similarly, in *Matter of Housman*, 4 Dem. (N.Y.) 404, relied on by the petitioner (Br. 36), the only depreciation allowed was with respect to household furniture. Although the trust property included a house, no one contended that depreciation should be deducted on account of the house. Moreover, it appears from the report that no charge had been made against the life tenant's income on account of renewals of the furniture.

arose only with respect to machinery, some of which, although kept in repair, had become obsolete. Moreover, the only charges for repairs or renewals which had been made against income were (p. 50) for "beltings, brushes, perishable rollers, and other articles which required constant replacing." No charges for replacement of the machinery itself had been made. In the present case, it does not appear that any item has become obsolete, nor does it appear that the life tenants have not already been charged in full for repairs and renewals.

The petitioner does not cite any case from any jurisdiction holding that a trustee may properly withhold from the income of a life beneficiary of a trust a gross sum on account of the depreciation of a building included in the trust property. We are confident that there are no such cases. Although a trustee may properly expend from the gross income of the trust all sums that are necessary to keep the buildings in tenantable repair, depreciation is not a charge which looks toward repair. It is rather a provision for the replacement of the buildings when they have become obsolete or useless. It has long been settled that the cost of permanent replacements and improvements of real property are not chargeable against the income of the life beneficiary of a trust. Restatement of Trusts, Section 225, Comment *i*; *Abell* v. *Brady*, 79 Md. 94, 101; *Greene* v. *Greene*, 19 R.I. 619, 625–626. Depreciation (after all repairs have been made) is a proper charge to the capital of the trust, just as an increase in the market value of land held by the trust results to the benefit

of the capital interests. Land and buildings may, despite the lapse of time, greatly increase in value, and this increase goes to the remainderman.[7] Similarly, if the trust property is invested in land and buildings, the risk of loss through depreciation (after all repairs have been made) must be borne by the remainderman. This, we submit, is a correct statement of the law of trusts.

Finally, we are not confined to an investigation of the law on this subject even though that law be clear. It is, of course, well settled that the long continued practical construction of an instrument will be controlling in the courts when there is any doubt or ambiguity in the instrument itself. *Old Colony Trust Co.* v. *Omaha*, 230 U.S. 100, 118. In this case the instrument was the will of the testator, and the trustee was the person primarily charged with carrying it out according to its terms. In fulfilling this duty, the trustee for a period beginning sometime after 1906 and extending to 1928, or more than twenty years, distributed the income of the trust to the life beneficiaries without withholding any sum for depreciation. During all of this period accounts were rendered annually in writing to the beneficiaries and were accepted by them. (R. 128.) Moreover, the failure to withhold depreciation was not a mere matter of oversight on the part of the trustee. His

[7] The remaindermen in this case have benefited from such gains. The trustee's answer to the remaindermen's objection to his account states that "large gains and profits have been made through sales and other dealings in bonds and real property of the estate, and that said profits have been applied in increasing the capital of said trust estate." (R. 134.)

attention was specifically directed to the question at least as early as 1917, for, in that year and in each succeeding year, the trustee included a deduction on account of depreciation in his fiduciary returns of the income of the trust estate. See *Appeal of Louise P. V. Whitcomb*, 4 B.T.A. 80, 82: R. 37–38. In the light of this practical construction, long continued, unbroken, and unchallenged until after the decision in *Whitcomb* v. *Blair*, 25 F. (2d) 528, *supra*, had shown possible advantage from a challenge, there is small basis for the contention that the trustee should have made a deduction for depreciation from the income of the life beneficiaries.

In the preceding argument we have assumed with the petitioner that the income *distributable* within the meaning of Section 219 of the Revenue Act of 1921 is the income which may ultimately be determined to be distributable regardless of the time when that ultimate determination is made. We contend, however, that this construction of the word is too broad. The Revenue Acts are designed to raise an annual revenue, and Congress obviously did not intend that the determination of the facts necessary to the computation of the tax for a particular year, might be postponed indefinitely and affected by events occurring long after that year.

We submit that income distributable within the meaning of Section 219 is income which was reasonably regarded by the parties as distributable at the

time it was distributed.[8] The income in question here was plainly so regarded. It was subject to the unfettered control and command of each beneficiary as soon as it was received. The liability for the tax then attached and should not be affected, we submit, by events occurring years later. In *North American Oil Consolidated* v. *Burnet*, 286 U.S. 417, 424, this Court held:

> If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent. * * * [9]

Even if it should be properly decided that the amounts actually distributed were not in fact distributable, the situation is not distinguishable, we submit, from that in *Ford* v. *Commissioner*, 51 F. (2d) 206, certiorari denied, 284 U.S. 666. There the

[8] This is not an argument that all items distributed are taxable. It is an argument as to the proper construction of the word "distributable." There is obviously no danger in this of double taxation, despite the petitioner's argument to the contrary. (Br. 23–24.) The same test applies to both parties, and whatever is "distributable" to the beneficiaries may be deducted by the trustee.

[9] The petitioner argues (Br. 25) that the *North American Oil Consolidated* case is not in point because it did not involve Section 219. But this does not seem to be a sufficient basis of distinction. The case does hold that taxability under the income tax laws is to be determined as of the date of receipt, and that taxability at that time is not affected by subsequent events.

executors of an estate in 1920 distributed certain stocks to legatees who in 1922 received dividends thereon. In 1926, the appropriate probate court held that the distribution had been premature and ordered the legatees to account for the principal and income from the stock from the date of distribution to December 31, 1922. In rejecting the contention that the dividends were not taxable income to the legatees when received in 1922, the court said (p. 207):

> We think these 1922 dividends were taxable income received by the petitioners during that year. Certainly they then had complete legal title to the stock and to the dividends. If taxes regularly assessed could be invalidated, an indefinite number of years later, by a consent judgment purporting to vacate the title of the taxpayer to the fund he had reported as income, the necessary system of tax collection would be much impaired. The true normal criterion to be applied in this class of case is the actual receipt and retention during the year in question of what was then considered to be income, not whether the taxpayer exposed himself to possible personal liability.

See also *Wear* v. *Commissioner*, 65 F. (2d) 665, 668 (C.C.A. 3d); *United States* v. *Mahoning Coal R.R. Co.*, 51 F. (2d) 208 (C. C. A. 6th), certiorari denied, 285 U. S. 559; *Jackson* v. *Smietanka*, 272 Fed. 970 (C.C.A. 7th). Compare Point IV of this brief (*infra*, pp. 40–43).

This construction of the statute is also supported, we submit, by the many cases holding that a tax-

payer may not defer reporting income actually received under a claim of right on the ground that claims are being asserted the outcome of which may later deprive him of it, or on the ground that there are limitations or potential liabilities which may affect his right to dispose of the income. *Commissioner* v. *Brooklyn Union Gas Co.*, 62 F. (2d) 505 (C.C.A. 2d); *Board* v. *Commissioner*, 51 F. (2d) 73 (C.C.A. 6th), certiorari denied, 284 U.S. 658; *Cleveland Ry. Co.* v. *Commissioner*, 36 F. (2d) 347 (C.C.A. 6th), certiorari denied, 281 U.S. 743; *Newman* v. *Commissioner*, 40 F. (2d) 225 (C.C.A. 10th), certiorari denied, 282 U.S. 858; *Rodrigues* v. *Edwards*, 40 F. (2d) 408 (C.C.A. 2d); *Vang* v. *Lewellyn*, 35 F. (2d) 283 (C.C.A. 3d).

III

THE ORDER OF THE CALIFORNIA COURT IS NOT CONCLUSIVE IN THIS PROCEEDING

The petitioner's argument is based primarily upon the effect which he contends must be given to the order of the California Superior Court entered on September 19, 1928. The authorities to the effect that that decision is not conclusive appear to be so clear as to make reference to them hardly necessary. But the petitioner argues so strenuously that the State court's order is conclusive that we are impelled to advance some of the many authorities to the contrary.

The petitioner concedes, of course, that the judgment is not binding here on the basis of *res judicata*

(Br. 28), since the United States was not and could not have been a party to the proceeding in which it was entered. It is equally obvious that the decision is not binding here as an *in rem* decree; there was no *res*, no question of title to specific items of property. The only effect, therefore, which can be given to the order is that resulting from the consideration and respect which is always accorded to the decisions of State courts. It has long been settled that the only decisions of State courts which are conclusive upon the Federal courts are those of the highest court of the State interpreting State statutes or applying a settled rule of property.

The petitioner relies on Section 905 of the Revised Statutes (U.S.C., Title 28, Sec. 687) and says (Br. 31) that the "argument of the Commissioner and the holding of the court below fly in the teeth" of this statute. Apart from the fact that this statute has no application except where a judgment can be relied on as *res judicata* (*Bigelow* v. *Old Dominion Copper Co.*, 225 U.S. 111; *Knights of Pythias* v. *Meyer*, 265 U.S. 30), it seems obvious that the petitioner is only attempting to resurrect an argument that has been dead for nearly a century. As long ago as *Swift* v. *Tyson*, 16 Pet. 1, this Court rejected a similar contention made with respect to the 34th Section of the Judiciary Act of 1789, c. 20, 1 Stat. 73, 92, providing that the laws of the several States should be regarded as rules of decision in trials at common law in the Federal courts in cases where they applied.

In *Lane* v. *Vick*, 3 How. 463, the Court, citing *Swift* v. *Tyson*, construed a will for itself in determining the rights of beneficiaries, although the State court in another proceeding had adopted a different construction. This Court said (p. 476):

> With the greatest respect, it may be proper to say, that this court do not follow the state courts in their construction of a will or any other instrument, as they do in the construction of statutes.
>
> Where, as in the case of *Jackson* v. *Chew*, 12 Wheat., 167, the construction of a will had been settled by the highest courts of the state, and had long been acquiesced in as a rule of property, this court would follow it, because it had become a rule of property. The construction of a statute by the Supreme Court of a state is followed, without reference to the interests it may affect, or the parties to the suit in which its construction was involved. *But the mere construction of a will by a state court does not, as the construction of a statute of the state, constitute a rule of decision, for the courts of the United States.* (Italics ours.)

The rules thus announced were approved and applied in many cases, including *Oates* v. *National Bank*, 100 U.S. 239, 246, *Railroad Co.* v. *National Bank*, 102 U.S. 14, 29, 55, *Burgess* v. *Seligman*, 107 U.S. 20, 33–34, and in *Bucher* v. *Cheshire Railroad Co.*, 125 U.S. 555. In *Barber* v. *Pittsburgh, Fort Wayne and Chicago Ry. Co.*, 166 U.S. 83, the con-

troversy related to the construction of a will which had previously been interpreted by the Supreme Court of Pennsylvania. This Court stated the question presented in these words (p. 99):

> The question, whether the opinion of the Supreme Court of the State in the former action is conclusive evidence of the law of Pennsylvania in a court of the United States depends upon the further question whether the opinion is declaratory of the settled law of Pennsylvania as to the effect of such devises, or is a decision upon the construction of this particular devise.

The court then considered the decision of the Pennsylvania Court, held that it did not represent a settled rule of property in that State, and concluded that it was not binding in the Federal Court.

The principles of these cases were reviewed in detail in *Kuhn* v. *Fairmont Coal Co.*, 215 U.S. 349. And, finally, in *B. & W. Taxi Co.* v. *B. & Y. Taxi Co.*, 276 U.S. 518, the same cases were relied on by this Court in upholding the validity of a contract although the state court had held such contracts invalid. The Court pointed out that the applicable rule was that in the absence of a local statute the Federal courts are free to exercise their independent judgment in the construction of wills, commercial papers, insurance policies, and on other questions of general law.

The principle established by these cases would seem to require the conclusion that the order of the state court in this case is not conclusive upon this Court

and the court below in determining the distributable shares of the beneficiaries of the trust involved. No question of the construction and application of a state statute was involved, nor can the order be considered an application of a settled rule of property in the State. There is nothing to show that by repeated decisions of the highest court of California, long acquiesced in, there is an established rule of property in that State requiring the trustee of a testamentary trust, who is directed to distribute the income periodically to named beneficiaries in designated shares, to set aside any portion of such income as a reserve for depreciation of the trust property. Not only are there no such decisions in California, but there do not appear to be any such decisions in any court so far as real property is concerned. The decision in *In re Gartenlaub*, 185 Cal. 648, upon which the petitioner so strongly relies, does not establish any such rule. That case deals with the specialized question whether a trustee who purchases bonds at a premium should amortize that premium out of trust income. That is a question which has been passed upon in many cases, but a decision by a state court on that question falls far short of establishing a settled rule that the trustee should withhold a gross sum on account of the depreciation of trust property.

The cases relied on by the petitioner are, we submit, distinguishable. Several of them [10] involved State

[10] Including *Keith* v. *Johnson*, 271 U.S. 1; *United States* v. *Kombst*, 286 U.S. 424; *Michigan* v. *Michigan Trust Co.*, 286 U.S. 334, and *Pitman* v. *Commissioner*, 64 F. (2d) 740 (C.C.A. 10th).

decisions construing and applying a State statute, a field in which State decisions have always been regarded as conclusive. Others[11] involved an *in rem* decree.

In *Uterhart* v. *United States*, 240 U.S. 598, there had been a decision of the State court as to the meaning and effect of a will at the time of probate and the question before this Court was the application of the Federal legacy tax to the interest so established. There was no suggestion that the decision of the State court did not represent a considered judgment on the question. The United States admitted the State decree to be binding (240 U.S. 603) and although the opinion does not expressly say so, it is not unlikely that the State decree there was an application of a settled rule of property in the State. In the present case, the State order was entered after the taxable years involved, nearly forty years after the probate of the will, after the trust income had been distributed regularly for many years without any reservation for depreciation, and after the will had been construed by Federal tribunals and taxes had been imposed for earlier years in accordance with that construction.

In *Commissioner* v. *Field*, 42 F. (2d) 820 (C.C.A. 2d), the taxpayer was the beneficiary of a trust created by the will of his grandfather. Prior to the taxable year involved (see 15 B.T.A. 718), a decree

[11] *Atwood* v. *Rhode Island Hospital Trust Co.*, 34 F. (2d) 18 (C.C.A. 1st); *Boal* v. *Metropolitan Museum of Art*, 19 F. (2d) 454 (C.C.A. 2d). "A proceeding for the probate of a will is a proceeding in rem * * *." 2 Freeman, *Judgments* (5th ed.) Sec. 811.

had been entered by a State court holding that the taxpayer received his interest free of any restraints on alienation. Thereafter the taxpayer assigned a portion of his interest, and he did not in fact receive the income from this portion in the year in question. The question presented in the Federal court was whether the taxpayer was nevertheless taxable on this assigned income. In the present case, the beneficiaries received and enjoyed the income and the decree of the State court was not obtained until after the tax controversy had arisen many years later. In *Farwell* v. *Commissioner*, 38 F. (2d) 791 (C.C.A. 2d), the payments in question had actually been made and approved by the State court long before the Federal tax question arose.

McCaughn v. *Girard Trust Co.*, 19 F. (2d) 218 (C.C.A. 3d), involved a provision for accumulation which was invalid on its face. The State court decision related to the very existence of the trust and not as here to a mere matter of the administration of a trust that had been in existence nearly forty years. The opinion of the Circuit Court of Appeals does not disclose passive acceptance of the State court order but rather an independent decision of the question on the merits.

The true rule to be deduced from all the cases is, we submit, that when a State court of appropriate jurisdiction has determined the extent of the rights of the parties under a will or a trust, and payments are thereafter actually made to the parties in accordance with that decision, then the State decision is conclusive in determining their Federal tax liability, not

as an adjudication or determination of the law, but because it has as a matter of fact determined the payments which the parties have received. Where, however, as here, the State court decision did not in fact control the amount of the payments, because it was not made until many years later, the State court decision is without effect in determining Federal tax liability because it did not in fact determine the payments actually made. And this is especially true where the State court decision is in effect a mere declaration which has never been complied with by actual payment, and the parties show plainly that they do not intend that it should be so complied with. The fact remains that the beneficiaries here received the money, and (except for the one unidentified payment of $10,700) still have it.

In the preceding argument it has been assumed that the decision of the State court in this case represented an actual adjudication of the question involved. The inference that it was not such an adjudication, however, seems irresistible.[12] A consideration of the facts shown by this record makes it plain, we contend, that the order of the State court was nothing more than a friendly settlement without any real contest, and requires the inference that the primary, if not the sole, object of the proceeding was to establish a basis for a deduction of depreciation

[12] This, of course, is not a contention that the State court order was invalid or improper. The argument relates only to the effect to be given the order.

for Federal income tax purposes. There was, of course, practically, such a community of interests that the apportionment of depreciation was largely a matter of indifference except as it might affect Federal tax liability. These facts may also be referred to:

1. The "account" of the trustee—the first he had rendered in more than twenty-five years—was filed five months after the decision of the Court of Appeals of the District of Columbia in *Whitcomb* v. *Blair*, 25 F. (2d) 528, *supra*, and while the present proceedings had been pending before the Board for more than two years.

2. The "account" contains no information whatever except a statement of the aggregate of receipts and expenditures for each year. (R. 110–125.)

3. The answer of the remaindermen was filed two days after the account was filed (R. 129, 136), although these remaindermen were resident in France.

4. The decree absolved the trustee from all liability (R. 142–143), although it is well settled that good faith and advice of counsel are no defense to a trustee who pays trust property to the wrong beneficiary. See Restatement of Trusts, Section 218; *Bate* v. *Hooper*, 5 DeG. M. & G. 338.

5. Although the "account" is for fiscal years ending February 23, the decree determines depreciation for calendar years.

6. No allowance was made for the statute of limitations which would apparently be

applicable to overpayments of money such as were said to have been made here. 2 Perry, Trusts (7th ed.), Sec. 855.

7. The decree directs repayment of the amounts representing depreciation only for the years beginning with 1913, *the income tax years.* The record shows plainly that the trust contained depreciable property prior to 1913. (R. 68, 69, 70.)

8. The amount of depreciation determined in the order is precisely the amount claimed by the trustee in his returns and claimed by the beneficiaries in the several proceedings before the Board.

9. The decree has never been complied with in terms.

10. The notes given in purported compliance with the decree (R. 145–148) are payable without interest either for the period before or following the decree. The amount of the note signed by each beneficiary is not even approximately the amount he was held to have been overpaid.

11. The notes are not payable until "the termination of said trust," at which time they will in large part be payable by mere bookkeeping transactions out of the remaindermen's interests.

12. The largest of the notes is signed jointly by two of the remaindermen and their mother. These two remaindermen have never received a cent of the trust income. They were in no way liable to restore any sum to the trust, and the only effect of their signature on the notes is that when their mother dies and

> the trust terminates they will become the beneficial payees of the note (unless they both die before their mother).[13]

The inference from these facts that the court decree was a friendly arrangement and not a considered judgment seems inescapable. The judgment of the State court entered in such a proceeding is only a *pro forma* determination and certainly should not be accepted as binding upon the Federal courts with respect to past rights, if it is entitled even to that respectful consideration accorded to the decisions of State courts.

In *Fidelity & Columbia Trust Co.* v. *Lucas*, 52 F. (2d) 298 (W.D.Ky.), the taxpayer's contention was similar to that made here. The court concluded (p. 301) that "the judgment relied upon must be regarded as nothing more than an agreed judgment." It then said:

> Under these circumstances it would shock one's sense of justice to hold that the government is concluded by the state court judgment. Furthermore, it is well settled that a decision of a state court, establishing a local rule of property or, construing a state statute or a contract made after the rights of a litigant in a federal court suit had accrued, and in a case to which he was not a party, is not binding upon the federal court. I know

[13] It seems not unlikely that the parties had in mind the decision of the Supreme Court of California in *Gordon* v. *Wansey*, 21 Cal. 77, that a note which becomes payable to one of its joint makers is extinguished. To the same effect is *Snell* v. *Davis*, 149 Ill. App. 391; 1 Williston, *Contracts*, p. 630.

> of no reason why this rule should not apply to the construction of wills. See *Kuhn* v. *Fairmont Coal Co.*, 215 U.S. 349, and authorities there cited.
>
> I therefore conclude that I am not only free, but it is my duty, to make my own construction of the will in this case.

The decision in that case was reversed by the Circuit Court of Appeals for the Sixth Circuit (*Fidelity & Columbia Trust Co.* v. *Lucas*, 66 F. (2d) 116), not upon the ground that the judgment of the State court was binding, but because the Circuit Court of Appeals agreed with the construction placed upon the will by the State court.

The petitioner raises one further point with respect to the court decree. He contends (Br. 26) that it is controlling because Congress has expressly made it controlling by directing in Section 219 (d) of the Revenue Act of 1921 (*infra*, p. 46) that each beneficiary shall include in his return of income the amounts which were distributable to him "pursuant to the instrument or order governing the distribution." The petitioner contends that the order of the California court was the "order governing the distribution" and that, therefore, Congress has expressly directed that it shall be controlling.

In the first place, it seems obvious that the order in question could not have been the "order governing the distribution" when the distribution was made many years before the order existed. However that

may be, we submit that the words "order governing the distribution" do not have the significance attributed to them by the petitioner. The provisions of Section 219 (d) expressly refer to those of Section 219 (a) (4) (*infra*, p. 45), in which Congress directed that the income tax provision should be applicable to two different situations: (1) income distributed periodically to the beneficiaries of estates or trusts, and (2) "income collected by a guardian of an infant to be held or distributed as the court may direct." This separation of the two classes of income and recognition of the two types or methods of distribution are maintained throughout the other subdivisions of the same section of the statute (subdivisions (c), (d) and (e) of Section 219). From this it is quite clear that the reference in the statute to the "order governing the distribution" applies to income collected by a guardian for an infant and has no application to the income of a trust which is distributed periodically to the beneficiaries. With respect to the latter type of income, the statute makes the "instrument" the governing criterion.

The provisions of Section 219 (b) of the Revenue Acts of 1924 and 1926 (*infra*, pp. 48–50), where the reference to court orders is confined solely to distributions by a guardian to an infant, plainly shows that Congress contemplated that the distribution of trust income was governed by the trust instrument. The change in the language of the later Acts was solely

for the purpose of clarifying the existing law. See Senate Report No. 398, 68th Cong., 1st Sess., p. 25; House Report No. 179, 68th Cong., 1st Sess., p. 21. These later Acts are involved in some of the other cases whose decision depends on that made in this case.

IV

THE EFFECT OF THE CALIFORNIA COURT DECREE IS AT MOST TO ENTITLE THE BENEFICIARIES TO A DEDUCTION FROM THEIR INCOME IN THE YEAR IN WHICH THEY MAKE PAYMENT PURSUANT TO THE DECREE

The petitioner's decedent, as well as the other beneficiaries, received and retained the entire amount of the income here in question during the taxable years involved. When it was received it was subject to no lien or other charge. The beneficiaries were free to use it and spend it as they wished. The beneficiaries made their tax returns on the basis of cash receipts and disbursements (at least we may assume so, as the record does not show the contrary). We submit that the amounts so received were income in full when they were received, and that the effect of the California court decree is at most to entitle the beneficiaries to a deduction in the year in which any payments are actually made pursuant to the decree.

No part of the income so received by the beneficiaries has been repaid to the trustee, except the sum of $10,700 repaid by the petitioner, and there is nothing to indicate for what year this repayment was

made nor when it was made.[14] This payment represents approximately 7 percent of the amount due from the petitioner and his decedent under the decree. No notes or other obligations evidence even a simulated intention to repay the other 93 percent. We submit that at least until the taxpayer has actually repaid the sums in question he is in no position to complain that he was subjected to taxation on the payments made to him when they were received.

When repayments to the trustee are in fact made they may form a basis for a deduction in the year of repayment,[15] but they cannot operate retroactively

[14] The total amount of depreciation set forth in the Superior Court decree is $622,434.11. (R. 40.) Calculation shows that the amount of this depreciation properly attributable to the petitioner and his decedent is $151,553.63, of which over $100,000 is attributable to the period before 1921. It would seem proper to apply the payment of $10,700 against the earlier years first. It would not have covered the amount due under the order of the Superior Court for the years 1913 and 1914.

[15] The petitioner cites *Pyle* v. *Commissioner*, 16 B.T.A. 218, as an authority for the proposition that the beneficiaries may not deduct repayments to the trustee in the year in which they are made. In that case the trustee withheld from the beneficiary in 1921 a sum necessary to make up for an overpayment in 1920. The only question which the Board considered was whether the full sum was "distributable" in 1921. The Board apparently overlooked the question that, assuming that the full sum was "distributable" in 1921, the beneficiary might be entitled to a deduction.

We agree with the petitioner that the repayment would not be within the deduction for "ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business", allowed by Section 214 (a) (1) of the 1921 Act. The petitioner does not, however, refer to the provision of Section 214 (a) (5) allowing a deduction

to render the amounts actually received any less income taxable to the beneficiaries in the year such income was received. *Burnet* v. *Sanford & Brooks Co.*, 282 U.S. 359.

In *Chicago, R. I. & P. Ry. Co.* v. *Commissioner*, 47 F. (2d) 990 (C.C.A. 7th), certiorari denied, 284 U.S. 618, it was contended that an item was not properly taxable as income because the taxpayer might thereafter have to refund portions of it. The court, however, rejected the argument, saying (p. 992):

> In case petitioner were subsequently required to pay any of these sums, it would be entitled to a deduction for the amount thus paid in the year it was paid.

To the same effect is *Charleston & W. C. Ry. Co.* v. *Burnet*, 50 F. (2d) 342, 343 (App.D.C.). See also *North American Oil Consolidated* v. *Burnet*, 286 U.S. 417, *Ford* v. *Commissioner*, 51 F. (2d) 206, certiorari denied, 284 U.S. 666, and the other cases cited and discussed at pp. 25–27, *supra*.

Whether the beneficiaries in this case will or will not be entitled to a deduction if and when they make

---

for "Losses sustained during the taxable year * * *, if incurred in any transaction entered into for profit, although not connected with the trade or business." The receipt of income from a testamentary trust would seem to be as much a transaction entered into for profit as is the receipt of a bequest or devise of property. When such property is sold for less than its value at the time of the bequest or devise, it has been held that there is a loss which may be deducted under Section 214 (a) (5). *Appeal of Williams*, 1 B.T.A. 1101.

repayments to the trustee does not, however, seem to be material here. Our contention is that since the payments made to the beneficiaries were received by them without restriction, they were taxable when received, and the greatest effect that can be given to the subsequent court decree is to establish a basis for a deduction if Congress has authorized such a deduction.

CONCLUSION

The decision below is correct and should be affirmed.

Respectfully submitted.

J. CRAWFORD BIGGS,
Solicitor General.
ERWIN N. GRISWOLD,
SEWALL KEY,
JOHN MACC. HUDSON,
Special Assistants to the Attorney General.

NOVEMBER, 1933.

APPENDIX A

STATUTES INVOLVED

The Revenue Act of 1921, c. 136, 42 Stat. 227, 239–240, 246–247, provides in part as follows:

SEC. 214. (a) That in computing net income there shall be allowed as deductions:

* * * * *

(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; * * *

* * * * *

(8) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. In the case of such property acquired before March 1, 1913, this deduction shall be computed upon the basis of its fair market price or value as of March 1, 1913;

* * * * *

ESTATES AND TRUSTS

SEC. 219. (a) That the tax imposed by sections 210 and 211 shall apply to the income of estates or of any kind of property held in trust, including—

(1) Income received by estates of deceased persons during the period of administration or settlement of the estate;

(2) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests;

(3) Income held for future distribution under the terms of the will or trust; and

(4) Income which is to be distributed to the beneficiaries periodically, whether or not at regular intervals, and the income collected by a guardian of an infant to be held or distributed as the court may direct.

(b) The fiduciary shall be responsible for making the return of income for the estate or trust for which he acts. The net income of the estate or trust shall be computed in the same manner and on the same basis as provided in section 212, except that (in lieu of the deduction authorized by paragraph (11) of subdivision (a) of section 214) there shall also be allowed as a deduction, without limitation, any part of the gross income which, pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in paragraph (11) of subdivision (a) of section 214. In cases in which there is any income of the class described in paragraph (4) of subdivision (a) of this section the fiduciary shall include in the return a statement of the income of the estate or trust which, pursuant to the instrument or order governing the distribution, is distributable to each beneficiary, whether or not distributed before the close of the taxable year for which the return is made.

(c) In cases under paragraphs (1), (2), or (3) of subdivision (a) or in any other case within subdivision (a) of this section except paragraph (4) thereof the tax shall be imposed upon the net income of the estate or trust and shall be paid by the fiduciary, except that in determining the net income of the estate of any deceased person during the period of administration or settlement there may be

deducted the amount of any income properly paid or credited to any legatee, heir, or other beneficiary. In such cases the estate or trust shall, for the purpose of the normal tax, be allowed the same credits as are allowed to single persons under section 216.

(d) In cases under paragraph (4) of subdivision (a), and in the case of any income of an estate during the period of administration or settlement permitted by subdivision (c) to be deducted from the net income upon which tax is to be paid by the fiduciary, the tax shall not be paid by the fiduciary, but there shall be included in computing the net income of each beneficiary that part of the income of the estate or trust for its taxable year which, pursuant to the instrument or order governing the distribution, is distributable to such beneficiary, whether distributed or not, or, if his taxable year is different from that of the estate or trust, then three shall be included in computing his net income his distributive share of the income of the estate or trust for its taxable year ending within the taxable year of the beneficiary. In such cases the beneficiary shall, for the purpose of the normal tax, be allowed as credits, in addition to the credits allowed to him under section 216, his proportionate share of such amounts specified in subdivisions (a) and (b) of section 216 as are received by the estate or trust.

(e) In the case of an estate or trust the income of which consists both of income of the class described in paragraph (4) of subdivision (a) of this section and other income, the net income of the estate or trust shall be computed and a return thereof made by the fiduciary in accordance with subdivision (b) and the tax shall be imposed, and shall be paid by the fiduciary in accordance with subdivision (c), except that there shall be allowed as an additional deduction in computing the net income

of the estate or trust that part of its income of the class described in paragraph (4) of subdivision (a) which, pursuant to the instrument or order governing the distribution, is distributable during its taxable year to the beneficiaries. In cases under this subdivision there shall be included, as provided in subdivision (d) of this section, in computing the net income of each beneficiary, that part of the income of the estate or trust which, pursuant to the instrument or order governing the distribution, is distributable during the taxable year to such beneficiary.

(f) A trust created by an employer as a part of a stock bonus or profit-sharing plan for the exclusive benefit of some or all of his employees, to which contributions are made by such employer, or employees, or both, for the purpose of distributing to such employees the earnings and principal of the fund accumulated by the trust in accordance with such plan, shall not be taxable under this section, but the amount actually distributed or made available to any distributee shall be taxable to him in the year in which so distributed or made available to the extent that it exceeds the amounts paid in by him. Such distributees shall for the purpose of the normal tax be allowed as credits that part of the amount so distributed or made available as represents the items specified in subdivisions (a) and (b) of section 216.

In the Revenue Act of 1924, c. 234, 43 Stat. 253, 269–270, Sections 214(a)(5) and 214(a)(8) (U.S.C., Title 26, Sec. 955), are substantially the same as Sections 214(a)(5) and 214(a)(8) of the Revenue Act of 1921 set out above.

Section 219 of the Revenue Act of 1924, c. 234, 43 Stat. 253, 275–277 (U.S.C., Title 26, Sec. 960), provides in part as follows:

ESTATES AND TRUSTS

SEC. 219. (a) The tax imposed by Parts I and II of this title shall apply to the income of estates or of any kind of property held in trust, including—

(1) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;

(2) Income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

(3) Income received by estates of deceased persons during the period of administration or settlement of the estate; and

(4) Income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

(b) Except as otherwise provided in subdivisions (g) and (h), the tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary. The net income of the estate or trust shall be computed in the same manner and on the same basis as provided in section 212, except that—

(1) There shall be allowed as a deduction (in lieu of the deduction authorized by paragraph (10) of subdivision (a) of section 214) any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in paragraph (10) of subdivision (a) of section 214, or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to

children or animals or for the establishment, acquisition, maintenance or operation of a public cemetery not operated for profit;

(2) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, and the amount of the income collected by a guardian of an infant which is to be held or distributed as the court may direct, but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not. Any amount allowed as a deduction under this paragraph shall not be allowed as a deduction under paragraph (3) in the same or any succeeding taxable year;

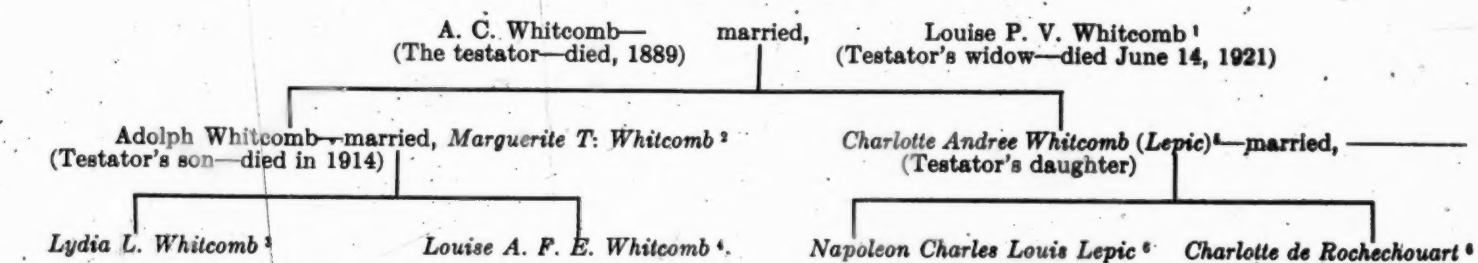
(3) In the case of income received by estates of deceased persons during the period of administration or settlement of the estate, and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir, or beneficiary.

(c) For the purpose of the normal tax the estate or trust shall be allowed the same credit as is allowed to a single person under subdivision (c) of section 216, and, if no part of the income of the estate or trust is included in computing the net income of any legatee,

heir, or beneficiary, then in addition the same credits as are allowed by subdivisions (a) and (b) of section 216.

Section 214 and Section 219 of the Revenue Act of 1926, c. 27, 44 Stat. 9, 26–28, 32–34 (U.S.C.App., Title 26, Secs. 955, 960) are substantially the same as the corresponding provisions of the Revenue Act of 1924.

APPENDIX B


A. C. Whitcomb—
(The testator—died, 1889)
married,
Louise P. V. Whitcomb [1]
(Testator's widow—died June 14, 1921)
Adolph Whitcomb—married, *Marguerite T. Whitcomb* [2]
(Testator's son—died in 1914)
Charlotte Andree Whitcomb (Lepic) [5]—married, ————
(Testator's daughter)
Lydia L. Whitcomb [3]
Louise A. F. E. Whitcomb [4]
Napoleon Charles Louis Lepic [6]
Charlotte de Rochechouart [6]

[1] The administrator of the estate of Louise P. V. Whitcomb is the petitioner in No. 129, involving the period from January 1 to June 14, 1921, and in Nos. 130 and 131, involving the period in 1921 after June 14, 1921, and the years 1922 to 1925, inclusive.

[2] Marguerite T. Whitcomb, also known as Marie M. E. G. Whitcomb, is the petitioner in Nos. 139, 141 and 144, involving the years 1921 to 1926, inclusive.

[3] Lydia L. Whitcomb is the petitioner in Nos. 146, 148 and 149, involving the years 1921 to 1926, inclusive.

[4] Louise A. F. E. Whitcomb is the petitioner in Nos. 145, 147 and 150, involving the years 1921 to 1926, inclusive.

[5] Charlotte A. W. Lepic is the petitioner in Nos. 140, 142 and 143, involving the years 1921 to 1926, inclusive.

[6] Napoleon Charles Louis Lepic and Charlotte de Rochechouart received no distributions of income from the estate, and their tax liability is not involved in any of the cases.

Names in italics represent persons living in 1928.

The will provided (R. 34–35) for the payment of one third of the income of the residue to Louise P. V. Whitcomb "for and during her natural life", and "the other two-thirds parts to my two children [Adolph and Charlotte] * * *, with the reversion or remainder of the whole three-thirds parts to the descendants 'per stirpes' of the said two children."

After the death of Adolph Whitcomb (which was prior to the years in question in these cases), his income interest was divided equally among his widow and his two children pending the termination of the trust on the death of Charlotte Andree Whitcomb Lepic.

After the death of Louise P. V. Whitcomb, the testator's widow, her income interest was divided equally between her estate, the testator's daughter, and the persons representing the testator's son, apparently on the theory that the testator had died intestate as to this portion of the income.

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